

# INVESTMENT STRATEGY

A.C.A. §§ 24-2-610-619

## DOMESTIC EQUITY

The Board has adopted a multiple manager equity investment strategy to increase diversification and enhance total rate of return.

The manager structure of the domestic equity portfolio's risk and style exposure should resemble the aggregate domestic equity market as measured by the Wilshire 5000 Index. To help achieve this goal, the Board will employ managers utilizing various or multiple capitalization (small, mid, and large) and investment styles (growth and value) so that the overall size and capitalization structure of the total component will approximate that of the broad market. To provide a broad base of low-cost diversification, the Board will allocate a portion of the domestic equity assets to a passive investment portfolio that approximates the return of the broad domestic equity market.

Domestic Equity Active/Passive Allocation (as a percent of the domestic equity portfolio)

|                   | Minimum | Target | Maximum |
|-------------------|---------|--------|---------|
| Active Component  | 50%     | 70%    | 90%     |
| Passive Component | 10%     | 30%    | 50%     |

The investment consultant will provide an annual report to the Board on the overall absolute and relative risk of the domestic equity component versus the broad market.

The goal for domestic equity investments shall be to achieve a total rate of return that will exceed, net of all fees and costs, the return of the aggregate domestic equity market as measured by the Wilshire 5000 Index over a full market cycle (approximately five years).

## INTERNATIONAL EQUITY

The Board has adopted a multiple manager international equity investment strategy to increase diversification and enhance total rate of return.

The manager structure of the aggregate international equity portfolio's risk and style exposure should resemble the aggregate international equity market as measured by the Morgan Stanley Capital International All Country World Ex-U.S. Index. To help achieve this goal, the Board will employ managers that invest in a broad array of countries (both developed and emerging markets), capitalization

(small, mid, and large), and style (growth and value) so that the overall style and capitalization structure of the total component will approximate that of the broad international market. An active management strategy for international equity investments will be used.

The investment consultant will provide an annual report to the Board on the overall absolute and relative risk of the international equity component versus the broad market.

The goal for international equity investments shall be to achieve a total rate of return that will exceed, net of all fees and costs, the return of the aggregate international equity market as measured by the Morgan Stanley Capital International All Country World Ex-U.S. Index over a full market cycle (approximately five years).

## **FIXED INCOME**

The Board has adopted a multiple manager fixed income investment strategy to increase diversification and enhance total rate of return.

The manager structure of the aggregate fixed income portfolio's risk exposure should resemble the aggregate domestic fixed income market as measured by the Lehman Brothers Universal Bond Index. To help achieve this goal, the Board will employ managers that invest assets in a broad array of sectors (government, mortgage backed, credits, asset backed, and commercial mortgage backed bonds), maturities, and credit qualities so that the overall portfolio structure is not materially different from that of the domestic fixed income market. To provide a broad base of low-cost diversification, the Board will allocate a portion of the fixed income assets to a passive investment portfolio that approximates the return of the broad fixed income market.

Fixed Income Active/Passive Allocation (as a percent of the fixed income portfolio)

|                   | Minimum | Target | Maximum |
|-------------------|---------|--------|---------|
| Active Component  | 85%     | 90%    | 95%     |
| Passive Component | 5%      | 10%    | 15%     |

The investments consultant will provide an annual report to the Board on the overall absolute and relative risk of the fixed income component versus the broad market.

The goal for fixed income investments shall be to achieve a total rate of return that will exceed, net of all costs and fees, the return of the aggregate domestic

fixed income market as measured by the Lehman Brothers Universal Bond Index over a full market cycle (approximately five years).

## **ALTERNATIVE INVESTMENTS**

The Board has adopted a multiple manager alternative investment strategy to increase diversification and enhance total rate of return.

The structure of alternative investments should include domestic and foreign private equity partnerships, venture capital, and mezzanine financing partnerships to diversify the assets and reduce the likeliness of material losses in any individual investment classification.

The investment consultant will provide an annual report on the overall absolute and relative risk of alternative investments to ensure that appropriate diversification is being achieved.

The goal for alternative investments is to achieve a total rate of return that will exceed, net of all costs and fees, the return of the public equity markets, as measured by the Wilshire 5000 Index, plus a liquidity premium of 2.0% per year.

## **REAL ESTATE**

The Board has adopted a strategy to increase diversification and enhance total rate of return.

The System may initiate direct ownership in raw land, commercial, industrial, and residential properties or indirect investments in fund of funds, partnerships, corporations, or real estate investment trusts investing in investment grade properties of like kind.

Total real estate investments shall not exceed the System's approved asset allocation as determined by the Board at the beginning of each fiscal year. Should the real estate allocation be exceeded, no additional real estate investments shall be entered into until the asset allocation exceeds the total real estate investments.

The Executive Director, subject to the approval of the Board, will appoint and retain a Real Estate Consultant to provide the necessary expertise and advice on such investments.

The goal of the real estate investments shall be to achieve a total rate of return that will exceed, net of all fees and costs, the return of the aggregate domestic real estate market as measured by the NCREIF National Property Index over a full market cycle (approximately five years).

## **TIMBERLAND**

The Board has adopted a strategy to increase diversification and enhance total rate of return.

The System may initiate direct ownership in timberland or indirect investments in fund of funds, partnerships, corporations, or real estate investment trusts investing in investment grade properties of like kind.

The goal of the timberland investments shall be to achieve a total rate of return that will exceed, net of all fees and costs, the return of the Southeast Timberland NCREIF index over a full market cycle (approximately five years).

## **ARKANSAS-RELATED INVESTMENTS**

The Board has adopted a strategy to meet the requirement of Arkansas statutes for Arkansas-related investments.

The System may initiate Arkansas-related mortgage loans, direct real estate investments, or purchase insured certificates of deposit or short-term securities of Arkansas financial institutions to meet the goals of the mandated requirements.

The Board has directed that Arkansas-related investments be in strict conformity with guidelines established by the Board.

The goal of Arkansas-related investments shall be to achieve a total rate of return that will exceed, net of all fees and costs, the return of the Lehman Mortgage Index as measured over a full market cycle (approximately five years).

## **CASH EQUIVALENTS**

The Board has adopted a strategy to preserve capital and maintain liquidity to meet the needs of the System.

The System may hold direct ownership in short-term investments or may permit or require managers to hold cash or cash equivalents to meet liquidity needs of the manager or of the System.

The goal of the cash management shall be to preserve capital and maintain liquidity.

## **COMMINGLED or MUTUAL FUNDS**

If a commingled fund or mutual fund is utilized, it is understood that the portfolio will be governed by the prospectus or similar document for the fund. In those cases, the System will utilize the ATRS Investment Guidelines in selecting and

evaluating funds initially and in monitoring them on an on-going basis for continued suitability. If the assets of the commingled or mutual fund participate in securities lending, the cash collateral should be prudently invested to avoid risk of loss.

## **DERIVATIVES**

Derivatives may be used to reduce the risk in a portfolio. At no time shall derivatives be used to create a position of leverage or substantially increase the risk of the overall portfolio. Each investment manager's derivative usage shall be specified in the investment management agreement or specific guidelines. The use of futures and options shall be matched by cash or cash equivalent securities, and all short futures positions shall be matched by equivalent long security positions. Option premiums outstanding at any given time shall be limited to less than 5% of the market value of the total portfolio. The notional value of the underlying securities of the futures contracts shall not exceed 15% of the market value of the total portfolio.

## **LOANING OF SECURITIES**

To increase investment income with minimal risk, the Board may loan bonds, stocks, or other securities provided at least 102% of the full market value of the security loaned is collateralized by cash or securities at the time the loan is executed.

At all times during the term of each loan, the collateral shall be equal to not less than 100% of the full market value calculated on the total value of all securities on loan.

**Adopted:** October 7, 2003